COLUMBIA LAW REVIEW.

Published monthly during the Academic Year by Columbia Law Students.

SUBSCRIPTION PRICE, $2.50 PER ANNUM — 35 CENTS PER NUMBER

NOVEMBER, NINETEEN HUNDRED AND EIGHT.

NOTES.

THE FIDUCIARY RELATION OF A PROMOTER.—A promoter bears a fiduciary relation both to the corporation and to the subscriber. As regards the corporation his position of advantage in dealing therewith creates this relation. 1 Morawetz, Priv. Corp. §545. His duty is to disclose the facts of such transactions in behalf of the corporation as it may adopt. *Yale Gas Stove Co.* v. *Wilcox* (1894) 64 Conn. 101. There is, however, no obligation to disclose dealings made before he became a promoter. *McElhenny's Appeal* (1869) 61 Penn. St. 188. The remedies open to a corporation for a breach of this obligation are rescission, or a suit in equity to recover the secret profits. *Cortes Co.* v. *Thannhauser* (1891) 45 Fed. 730.

Among cases in which a corporation has sought to recover profits made by promoters from a sale of property, clearly the sale may be avoided or secret profits recovered if the majority stockholders without knowledge of the facts adopted the transaction. Even though the majority knew the facts, if their action be not *bona fide* the corporation can recover by a minority stockholder's suit. *Hebgen* v. *Koeffler* (1897) 97 Wis. 313. But the promoters are not liable where they constitute the sole stockholders during

the life of the corporation, *Salomon* v. *Salomon & Co.* [1897] L. R. App. Cas. 22, or where, having organized and taken property with the view of continuing sole stockholders, after a considerable interval of time issue new stock to the public. *In re British etc. Box Co.* (1881) L. R. 17 Ch. Div. 467. Fraud cannot be predicated of such a dealing. Midway, lie two groups of cases. First, the promoters or their dummies become incorporators or directors of the newly formed corporation, make the sale before complete organization, and then call for subscriptions from outsiders. Here they have generally been held liable. *Hayward* v. *Leeson* (1900) 176 Mass. 310; *Erlanger* v. *New Sombrero etc. Co.* (1878) L. R. 3 App. Cas. 1218. Second, the promoters, having designedly issued a few shares of stock to themselves, adopt the sale, and immediately offer the remainder to the public. In a case of the latter sort the United States Supreme Court has recently held, contrary to the view in England, *Society of Practical Knowledge* v. *Abbott* (1840) 2 Beav. 559; (*semble*), *In re British etc. Co.* (1881) L. R. 17 Ch. Div. 467, and in Massachusetts on the same facts, *Old Dominion etc. Co.* v. *Bigelow* (1905) 188 Mass. 315, that the corporation has no remedy. *Old Dominion Copper Mining and Smelting Co.* v. *Lewisohn* (1908) 28 Sup. Ct. Rep. 634. The decision stands on the ground that, since all the stockholders for the time being knew the facts, their unanimous act cannot be a fraud upon the corporation. The court properly distinguishes on its facts *Erlanger* v. *New Sombrero etc. Co., supra,* (belonging to the first group), though its reasoning would undoubtedly cover the principal case.

Two other courses were open to the court. In the first, the court would be called upon to exaggerate the accepted distinction between the corporate entity and its stockholders. It was suggested in *Society of Practical Knowledge* v. *Abbott, supra,* and argued in *Salomon* v. *Salomon & Co., supra,* that the corporation is an entity so distinct, that it may be defrauded by the unanimous act of its stockholders. Hence, for a fraud upon the corporate interests, a new stockholder, like a minority stockholder, could sue in the name of the corporation. The argument is specious in assuming the interests of the corporation distinct from those of its stockholders. No court, it is believed, is prepared to go to this extent. It would lead to inextricable difficulties in the determination of the corporate interests, and to the result, rejected in *Salomon* v. *Salomon & Co., supra,* that the receiver of a corporation, whose stock was exclusively owned by the promoters during the entire life of the corporation, could recover profits made by them in a sale of their property to the corporation.

The court might more properly have looked beneath the technical distinction between the first and second groups of cases, and, viewing the transactions as in essence the same, have administered equitable relief. Cf. *Erlanger* v. *New Sombrero etc. Co., supra.* This apparently is the underlying basis of the Massachusetts decision. But that court professed to adopt the business view that the real corporation was one composed of the contemplated stockholders and that the knowledge of the promoter before the completion of such a corporation was not the knowledge of the entity. This theory, however, is logically open to criticism, and is unnecessary to support the true *ratio decidendi.* It might also, perhaps, be

argued that, under the circumstances of the principal case, the corporate interests should be determined by the interests of the contemplated stockholders as well as by those of the present stockholders. This would be a modification of the extreme entity theory, and perhaps represents the view of the English Court of Appeals in *In re British etc. Box Co., supra,* holding that an issue of stock to the public directly after the adoption of the transaction would be conclusive evidence of fraud on the corporation. It could hardly be regretted had the Supreme Court, exercising its equitable powers, brushed aside its technical argument and allowed the corporation relief.

It is probable, however, that, on the facts of the case, the subscribers had an individual remedy against the promoters. Though in most cases in which personal relief has been given the subscriber, the facts show misrepresentation, the broad ground of decision is that the promoter does not treat with the subscriber at arm's length, but in a fiduciary relation by virtue of which the promoter is bound to disclose all the facts. *Brewster* v. *Hatch* (1890) 122 N. Y. 349; *Teachout* v. *Van Hosen* (1888) 76 Ia. 113. The duty of the promoter to the subscriber is based upon the confidence the latter is likely to repose in the organizer of a corporation. 1 Morawetz, Priv. Corp. §545. That duty should therefore continue so long as he in effect acts in such a capacity, and should exist in the principal case, despite the fact that the promoter had also become a stockholder. If this be true, the refusal of the Supreme Court to relax sound legal theory in order to grant an additional remedy, may be supported.

STATE POLICY AND THE FULL FAITH AND CREDIT CLAUSE.—At the period of the Revolution, the doctrine with respect to the effect of foreign judgments *in personam* was unsettled both in England and on the Continent. Black, Judgments (2nd Ed.) Ch. 21, Pt. 2, *passim.* In the American colonies, the same uncertainty existed, *M'Elmoyle* v. *Cohen* (1839) 13 Pet. 312, and it was to promote comity and good will between the states, by enforcing respectful treatment of the acts and judicial proceedings of sister states, that Art. IV., Sec. 3 of the Articles of Confederation was adopted. See *People* v. *Dawell* (1872) 25 Mich. 247, 259. But the clause proved ineffectual; it neither declared what effect such acts should have, nor gave Congress power to legislate with respect thereto. *M'Elmoyle* v. *Cohen, supra.* These defects were eliminated by Art. IV., Sec. 1 of the Constitution, authorizing Congress to prescribe the method of proving sister state judgments and the effect thereof, and by act of Congress, May 26th, 1790, U. S. Comp. Stat. (1901), 677, declaring that "the said records and judicial proceedings * * * shall have such faith and credit given to them in every court within the United States as they have by law or usage in the courts of the state from whence the said records are or shall be taken."

The decisions involving a construction of Art. IV., Sec. 1, and the Act of 1790 have been remarkably consistent from the beginning. One of the earliest is *Armstrong* v. *Carson's Executors* (1794) 2 Dall. 302. A plea of *nil debent* to a judgment of a sister state was held bad, the court declaring that "if the plea would be bad in the courts of New Jersey, it is bad here." To the same effect are *Mills* v. *Duryee* (1813) 7 Cranch 481, and *Hampton*